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Organization & Compensation of Boards of Directors

By Edwin S. Mruk and James A. Giardina

Sponsored by the Financial Executives Institute

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Foreword

This study presents the findings of the 1985 survey of the organization and compensation of Boards of Directors. Edwin S. Mruk, a retired partner of Arthur Young, and James A. Giardina, a current partner of Arthur Young, conducted the study under the sponsorship of the Financial Executives Institute.

This report is based on data provided by nearly 600 publicly held corporations. Approximately one-half of the responding companies had more than $500 million in sales (or $4 billion in assets, in the case of financial services companies). The corporations included in the sample represent 26 industry classifications.

Arthur Young, the authors, and the Financial Executives Institute express their appreciation to the companies that provided the information on which this report is based. In addition, the authors gratefully acknowledge the assistance of Richard V. Nenna and Susan T. Hamill in the overall project management, and Thomas J. Gilman in the preparation of the data for analysis.

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Scope and Method of Study

The information for this year's study was accumulated by questionnaire. Participation was solicited from the corporate membership of the Financial Executives Institute and from other companies in a wide range of industries. In total, more than 800 companies responded to the survey, including nearly 600 publicly held corporations. This report is based on the data provided by the publicly held companies only. The participants provided data on the organization and compensation of their Boards of Directors and Board committees and on Board member views on key issues, including Board responsibilities, areas of influence, and emerging concerns.

Each response was reviewed for completeness and consistency to ensure accurate processing and appropriate use of information. Participants were asked to provide compensation data for their directors for the years 1983, 1984, and 1985. Compensation data for 1985 reflect compensation levels in effect as of the end of the first quarter of 1985. Compensation amounts reported are the amounts actually earned on an annual basis, regardless of whether the amounts were deferred in whole or in part.

Major Industry Groupings

Information concerning the organization and compensation practices of Boards of Directors was reported by companies representing a large number of industries. The industries were first grouped according to three major types, and these were further subdivided into 26 specific industries.

The Manufacturing Group

This group of industries includes companies that manufacture one or more products as their principal form of business. Although study information for this group was gathered from companies in a large number of industries, the analyses are heavily weighted by companies in the following classifications:

Durable Goods

- Basic Materials
- Electrical Machinery
- Fabricated Metal Products
- Instruments
- Machinery
- Primary Metals
- Transportation Equipment

Nondurable Goods

- Chemicals
- Food Products and Tobacco
- Paper Products
- Petroleum
- Publishing
- Textiles and Apparel

The Nonmanufacturing Group

This group of industries includes companies that perform one or more services as their principal form of business. While this group, by definition, encompasses a vast number of industries, the analyses presented in this report heavily reflect the responses of companies in the following classifications:

- Business Services
- Communications
- Construction and Contracting
- Mining and Energy Extraction
- Retail Sales
- Transportation
- Utilities
- Wholesale Trade
- Health Care

The Financial Services Group

This group of industries includes both companies that perform one or more financial services and companies that derive their income primarily from the management of financial assets. The analyses for this group typically reflect responses of companies in the following industry classifications:

- Banking (Commercial)
- Banking (Thrift Institutions)
- Diversified Financial Services
- Insurance

Specific Industry Classifications

The 26 industries that have been included in this study are defined as follows:

Banking (Commercial) Includes commercial banks, stock savings banks, and trust companies. Does not include mutual savings banks or other credit agencies. Standard Industrial Classification Codes*: 6000-6027.

Banking (Thrift Institutions) Includes mutual savings banks and credit agencies, such as savings and loan associations, and personal and business credit institutions. Standard Industrial Classification Codes: 6028-6044, 6114-6143.

Basic Materials Companies engaged in the manufacture or production of rubber and plastic products; stone, glass, and clay products; lumber and wood products; and furniture and furniture fixtures. Does not include metal mining. Standard Industrial Classification Codes: 2400-2599, 3000-3099, 3200-3299.

Business Services Includes companies rendering services such as advertising, management consulting, and commercial research; and services rendered by engineers, architects, accountants, and writers. Standard Industrial Classification Codes: 7000-7099, 7300-7399, 8900-8999.

Chemicals Companies engaged in the processing of chemicals and chemical products; includes pharmaceuticals. Standard Industrial Classification Codes: 2800-2899.

Communications Includes companies furnishing point-to-point communication services, whether by wire or radio, and whether intended to be received aurally or visually. Standard Industrial Classification Codes: 4800-4899.

Construction and Contracting Includes companies generally contracting for heavy construction: building, highway, bridge, tunnel, sewer, pipeline, power line, plumbing, electrical, carpentry, etc.; and other miscellaneous trade classifications, such as glazing, roofing, sheetmetal work, etc. Standard Industrial Classification Codes: 1500-1799.

Diversified Financial Services Companies engaged in the management of financial assets as their principal form of business, as well as holding companies having subsidiaries whose principal businesses represent more than one area of financial service. Also includes mortgage bankers and brokers. Standard Industrial Classification Codes: 6700-6799, 6045-6113, 6144-6299.

*Standard Industrial Classification Codes provide a means of classifying companies into industry groupings. They are standardized four-digit codes prepared by the Technical Committee on Industrial Classification of the Office of Management and Budget, Executive Office of the President.

Electrical Machinery Companies engaged in the manufacture of electrical machinery, equipment, and supplies. Standard Industrial Classification Codes: 3600-3699.

Fabricated Metal Products Companies engaged in fabricating ferrous and nonferrous metal products, such as metal cans, tinware, hand tools, general hardware, fabricated structural metal products, etc. Does not include manufacturers of ordnance, machinery, or transportation equipment. Standard Industrial Classification Codes: 3400-3499.

Food Products and Tobacco Companies engaged in the preparation of meat products, bakery products, beverages, confectionery and related products, grain mill and other food products, and tobacco. Standard Industrial Classification Codes: 2000-2199.

Health Care Includes hospitals, nursing facilities, medical service organizations, and research facilities. Standard Industrial Classification Codes: 8000-8099.

Instruments Companies engaged in the manufacture of scientific and control instruments, photographic and optical goods, and watches and clocks. Standard Industrial Classification Codes: 3800-3899.

Insurance Companies engaged in underwriting life, accident, health, fire, marine, casualty, and financial responsibility insurance. Standard Industrial Classification Codes: 6300-6499, 6600-6699.

Machinery Companies engaged in the manufacture of heavy machinery, such as steam engines, farm machinery and equipment, construction machinery, elevators, machine tools, textile machinery, etc. Does not include transportation equipment. Standard Industrial Classification Codes: 3500-3599.

Mining and Energy Extraction Companies engaged in the mining of metal, coal, and other minerals. Also includes related mining and energy extractive services. Standard Industrial Classification Codes: 1000-1499.

Paper Products Companies engaged in the manufacture of pulp, paper and paperboard, and converted products such as coated paper, paper bags, paper boxes, and envelopes. Does not include abrasive, carbon, or photosensitized paper products. Standard Industrial Classification Codes: 2600-2699.

Petroleum Companies engaged in petroleum refining and pipeline transportation. Standard Industrial Classification Codes: 2900-2999.

Primary Metals Companies engaged in metals processing such as smelting, refining, rolling, drawing, extruding, forging, casting, and blast furnace and foundry operations. Standard Industrial Classification Codes: 3300-3399.

Publishing Companies engaged in the printing and publishing of books, periodicals, and newspapers or in commercial printing, engraving, typesetting, photoengraving, electrotyping, book binding, greeting card and business form publishing, etc. Standard Industrial Classification Codes: 2700-2799.

Retail Sales Retail outlets marketing general merchandise, food products, automobiles, apparel, furniture, and home furnishings. Also includes restaurants. Standard Industrial Classification Codes: 5200-5999.

Textiles and Apparel Companies engaged in basic textile production (yarn production, dyeing, and cloth printing) and manufacture of apparel and other products using basic textiles as raw material. Also includes manufacturers of shoes and leather goods. Standard Industrial Classification Codes: 2200-2399, 3100-3199.

Transportation Railroads, motor, air, and water transportation companies, and motor freight transportation companies. Standard Industrial Classification Codes: 4000-4799.

Transportation Equipment Companies engaged in manufacturing equipment for transportation of passengers and cargo by land, air, and water. Includes manufacturers of motor vehicles, aircraft, boats, and railroad equipment. Standard Industrial Classification Codes: 3700-3799.

Utilities Companies engaged in distribution of electricity, gas, and water; and manufacturers of sewage and irrigation systems. Standard Industrial Classification Codes: 4900-4999.

Wholesale Trade Companies engaged as jobbers, distributors, or wholesalers of a variety of products. Standard Industrial Classification Codes: 5000-5199.

Overview

Historical Perspective

With public attention again focused on the roles and responsibilities of Boards of Directors in the governance of publicly held corporations, there has been a heightened recognition of how the quality of the Board can affect the future of the organization. Several recent corporate failures have caused members of the business community to question the quality of oversight provided by Boards. In addition, the recent heavy activity in the takeover arena has caused alarm and concern among shareholders regarding the degree of independent judgment exercised by Boards in determining the destiny of corporations.

This is not the first time that Boards have come under such scrutiny. Almost a decade ago, a number of reforms in Board organization and activity were initiated with the aim of improving corporate governance. The Securities and Exchange Commission (SEC) endorsed the concept of an independent Audit Committee of the Board. Furthermore, the New York Stock Exchange required domestic corporations with common stock listed on the Exchange to have Audit Committees composed solely of directors independent of management and free from any relationship that, in the opinion of the Board of Directors, would interfere with the exercise of independent judgment as a committee member. Under SEC rules, publicly held corporations must disclose whether their Boards have Audit, Compensation, and Nominating committees, and are required to disclose information on the membership, meetings, and functions of these committees. These companies are required to disclose the number of Board meetings held and the names of members attending less than 75% of the scheduled Board and Committee meetings. The SEC also requires disclosure of the reasons furnished by a director who resigns or does not stand for reelection because of disagreement with management over operations, policies, or practices, if that director requests that the information be made public. Finally, close family connections between directors or director candidates and company executives, specified supplier and customer relationships between directors or director candidates and the firm, and financial and legal ties of directors or director candidates to the firm are required to be disclosed.

The reforms initiated in the late 1970s have brought about a number of changes within Boards. Today, the existence of an Audit Committee of the Board, composed of independent, nonmanagement directors, is almost universal among publicly held companies. Compensation and Nominating Committees

have also become much more prevalent. Twelve years ago, the Conference Board reported that 46% of companies had Audit Committees, 69% Compensation Committees, and 7% Nominating Committees.* Compare those figures to the results of our current study: 97% of the companies report Audit Committees, 89% Compensation Committees, and 43% Nominating Committees. Boards today are composed of a majority of nonmanagement directors. In fact, nonmanagement directors typically make up two-thirds to three-quarters of Board membership. These structural changes in Boards, which resulted from the reforms initiated 10 years ago, have established a mechanism to facilitate oversight and safeguard independent judgment.

While recent events have renewed public recognition of how the quality of the Board can determine the future of the corporation, they also recall the standards of conduct described in the guidebooks developed by the Corporation, Banking, and Business Law Section of the American Bar Association. According to the guidebooks, an individual, by assuming directorship of a public corporation, pledges allegiance to the enterprise and acknowledges that the best interests of the corporation and its shareholders must prevail over any individual interests he or she holds.** The director assumes a duty to act prudently in fulfilling the important tasks of monitoring and directing the activities of corporate management.

Major Findings

The average Board of Directors today is remaining constant both in size and composition. The average Board size reported is 12 members, 71% of whom are classified as nonmanagement directors. Board Committees have become integral to the effective functioning of the Board. Audit, Compensation, Executive, and Nominating Committees are the most prevalent committees, reported by 97%, 89%, 63%, and 43% of the companies, respectively. The use of other committees has become widespread, as witnessed by the prevalence of the Finance Committee (22%) and a new committee studied for the first time this year, the Pension Review Committee (21%). In fact, it is not unusual for a Board to have seven or more standing committees.

*The Conference Board, Inc., *Corporate Directorship Practices: Membership and Committees of the Board*, 1973.

**The Committee on Corporate Laws Section of Corporation, Banking, and Business Law of the American Bar Association, The *Corporate Director's Guidebook* and *The Overview Committees of the Board of Directors*, The Business Lawyer, 1978 and 1979, respectively.

Compensation for Board members continues to increase, rising approximately 6% from 1984 to 1985. In addition, the differences we have witnessed in recent years in compensation levels among different industries are narrowing. For example, in our Board study published in 1981, manufacturing companies reported the highest average compensation paid to Board members, followed by nonmanufacturing and financial services companies. In that study, among companies paying both a retainer and meeting fee to Board members, manufacturing companies were paying, on average, 64% above the average paid in financial services companies. Today, average payments to Board members of manufacturing and nonmanufacturing companies are on a par, with payments to directors of financial services companies trailing by 14%.

The outlook for director compensation increases in the future suggests a continuation of moderate increases, with a greater emphasis on the non-cash elements of the compensation package. In this year's study, the "typical" nonmanagement director would be paid both a retainer and meeting fee for regular Board membership and attendance, amounting to approximately $15,300 if all meetings are attended. This director can expect to earn an additional $3,800 if he or she serves on two committees, again assuming all committee meetings are attended, and an additional $2,380 for chairing one of the committees. Total compensation, therefore, would amount to approximately $21,480, or $1,972 on a per-diem basis. This is less than 10% above the comparable figure reported for 1983.

Although director compensation has increased in recent years, on a per-diem basis it still falls short of the CEO per-diem compensation paid in companies of similar size. For example, data reported for the CEO in the 20th Anniversary Issue of *Executive Compensation*, our most recent study, show that in companies with sales of $2-5 billion, the CEO receives almost 15% more on a per-diem basis than a director serving on the Board of a company in the same sales category.

If we were to write a description for the position of director from the director's viewpoint, we would include several important responsibilities (see Table 1). The two primary responsibilities of the Board, as reported by directors, are "counseling top management" and "monitoring the performance of the Chief Executive Officer." Other duties of major importance reported by a majority of directors include "assuring a strategic plan for the future" and "assuring the integrity of the company's operations."

In contrast to what the Board views as its primary responsibilities, the Board sees itself as being most influential on decisions regarding the compensation of top management and on decisions related to mergers and acquisitions. On the other hand, less than half of the directors believe they exercise strong influence regarding one of their foremost responsibilities, counseling top management. Directors reported having the least influence on decisions related to day-to-day operations and the corporate organizational structure (see Table 2).

Table 1

Primary Responsibilities of the Board:
Percentage of Companies Ranking Each Item as First, Second, or Third Priority

RESPONSIBILITY	Manufacturing Group	Nonmanufacturing Group	Financial Services Group
Counsel Top Management	58%	61%	49%
Monitor the Performance of the CEO	57	51	57
Assure a Strategic Plan for the Future	53	58	53
Assure the Integrity of the Company's Operations	50	50	54
Assure Management Succession	43	38	32
Monitor Financial Reporting	23	24	18

Table 2

Influence of the Board on Key Management Decisions:
Percentage of Companies Indicating That the Board Has a Strong Influence

DECISION AREA	Manufacturing Group	Nonmanufacturing Group	Financial Services Group
Compensation of Top Management	72%	74%	77%
Mergers and Acquisitions	68	69	68
Management Succession	52	46	64
Counseling Top Management	42	43	38
Long-Range Strategic Planning	23	22	26
Selection of Senior Executives	20	30	34
Capital Expenditures	22	17	23
Day-to-Day Operations	7	1	10
Corporate Organizational Structure	4	4	4

To deal more effectively with areas of major importance to the corporation, the practice of holding special Board meetings devoted to single issues has become prevalent (see Table 3). Seventy-two percent of the companies reported holding such meetings. Long-range strategic planning meetings were the most prevalent (reported by 53% of the companies), although only one-fourth of the directors reported having much influence in this area. Meetings devoted to the compensation of top management (reported by 41% of the companies) constituted the second highest category, which is in line with the degree of influence Boards indicate they exert on compensation decisions.

The performance of Boards and individual Board members is constantly being assessed, as the contribution and effectiveness of directors is informally judged through their meeting participation, attendance, and committee activities. Ultimately, these judgments are acted upon in the ongoing nomination and election process. Additionally, some Boards undergo a formal "performance appraisal" on a regular basis. Five percent of the companies reported having a mechanism for evaluating the Board's performance and contribution on a regular basis, and 8% had one for the evaluation of individual Board member effectiveness. Where a formal mechanism was in place, performance assessment of the Board was most frequently a function performed regularly by the Nominating Committee (reported by approximately one-third of the companies) or conducted through an internal review and discussion process, often at a special Board meeting devoted to the evaluation (also reported by approximately one-third of the companies). For the evaluation of individual Board member performance, where a mechanism was established, director performance reviews were the responsibility of the Nominating Committee (reported by over half of the companies). Approximately one-fourth of the companies used a more informal review process, generally administered by the Chairman.

Table 3

Special Board Meetings:

Percentage of Companies Holding Special Board Meetings Devoted to Each Area

MEETING TOPIC	Manufacturing Group	Nonmanufacturing Group	Financial Services Group
Long-Range Strategic Planning	53%	52%	58%
Compensation of Top Management	40	41	43
Capital Expenditures	26	30	21
Management Succession	29	24	25
Corporate Organizational Structure	12	15	22

Concerns of Today's Directors

As the organization and role of the Board have been evolving over the last decade, the critical issues that concern Boards have also changed. We asked Board members to describe what, in their views, are the most critical issues with which Boards must contend over the next few years. Their concerns are as diverse as their companies. We do see several emerging trends, however, focusing largely on the Board's enhanced awareness of its responsibilities vis-a-vis the myriad complexities of today's business climate. In general descending order of magnitude, the issues listed by directors were as follows:

- Strategic planning
- Management succession
- Monitoring the financial health of the company
- Balancing the interests of management vs. shareholders
- Adjusting to global business
- Government policy
- Increasing litigiousness of society
- Monitoring the performance of the CEO and top management
- Redefinition of Board oversight

- ***Strategic planning.*** Ensuring that the corporation has developed a long-range plan that anticipates the changing nature of business and the economic climate will be a major focus of Boards over the next few years. This was the most frequently mentioned concern addressed by participants and was the subject of approximately one-third of the comments. Many comments in this regard were initiated by concerns within specific industries. Financial services companies were focusing on positioning themselves ultimately for nationwide banking, and manufacturing companies were focusing on adjusting to increased foreign competition. One Board member explained that his Board was challenging management to adjust to a slower growing world economy by decreasing the emphasis on the growth of existing businesses while expanding profit opportunities elsewhere through the development of new businesses. Many Boards have become more actively involved with management in the planning process. As one director explained, the new strategic planning has had to consider many changed assumptions about market growth, inflation rates, foreign competition, abnormally high real interest rates, and government policies.

- ***Management succession.*** Identifying talent for leadership of the organization continues to be a major challenge for Boards. One Board member described this as the "assurance of an adequate management team to insure corporate growth and stability in a period of increased world competition and changing management concepts." The pressure on the Board to assist in developing an organizational structure and strong management team is particularly great in businesses which are undergoing rapid growth, as well as those most affected by the internationalization of businesses and markets.

- ***Monitoring the financial health of the company.*** Boards are becoming more involved in monitoring the financial health of the company and in financial planning to assure the continued profitable growth and stability of the company. Boards are reviewing capital commitments to ensure that the financial direction of the company is appropriate for its long-term strategic direction, whether that means building reserves for maximum future financial flexibility, financing additional capital investment to better compete with foreign corporations, or financing continued growth, expansion, or diversification.

- ***Balancing the interests of management vs. shareholders.*** Some have called this the "Takeover Era." The large number of takeovers, both friendly and hostile, has raised many questions about whether the primary role of the Board is to protect shareholder interests or alternatively, to support management. One Board member admitted that in the future, Boards must "do a better job of representing the shareholders' interests—as opposed to managements' interests." Another Board member felt it is critical for Boards to "maintain a continued surveillance to ensure that the adequate representation of stockholders is balanced with the direction of the organization, and where a conflict may arise, to adequately serve the ownership interests." The obligations to shareholders, managements, employees, and communities on receipt of takeover offers present complicated problems for directors.

- ***Adjusting to global business.*** Virtually all industries have been affected by the world economy and the trend toward global markets and production. The strength of the dollar has accelerated this trend and magnified its effect on many industries. The foremost concern in the minds of many Board members is developing an organizational structure and business strategy to deal effectively

with the rapidly changing environment and the global nature of business. One Board member discussed the difficulties of adapting the organization to the significant economic changes facing the country; another discussed the challenge of planning to compete effectively with foreign corporations. The distress experienced by many Boards dealing with foreign competition registers clearly in this Board member's comment: "We are a capital intensive company, with high debt. We face increasing foreign competition. We need to redirect our resources to continue to grow at a time when many of our markets are flat to down. Our Board needs to better understand our situation so that we can develop a long-range strategic plan to survive and grow."

- ***Government policy.*** "Outguessing government actions, especially with regard to income tax laws and their effect on capital formation," was one Board member's priority concern. It is not surprising, given the recent and proposed changes in tax legislation, that assisting managements to plan effectively for, and then adapt operations to meet, changing government policy will continue to be an important activity for Boards. Directors are also concerned with the increasing regulation of some industries and deregulation of others, as they assist managements in planning how to respond to changes. Government policies regarding the direction and strength of the economy and the federal deficit are critical issues which concern Boards as well.

- ***Increasing litigiousness of society.*** Many Board members expressed concern about the growing number of lawsuits filed against both the Board and the company by shareholders and the general public. The potential for harm, to both directors and companies because of the time lost and money spent in responding to suits, not to speak of the often greater damage done to image and reputation through negative publicity, is enormous. Shareholders in particular have become increasingly aggressive in filing lawsuits against companies and their Boards, and frequently have the backing of the courts and government. Recent settlements have run into the millions of dollars. As a result, once-prized director posts are losing some of their appeal and are harder to fill with competent people.

To help protect Board members against financial risks, directors' and officers' liability insurance has become a necessity in attracting and retaining individuals to serve on Boards. Directors can still be personally liable for millions of dollars above their liability insurance coverage, however. Many directors expressed specific concern about their financial liability as Board members, especially in fast moving, crisis situations such as takeovers, buyouts, or merger proposals. Increased litigation (and threat of litigation) will likely force Board members to improve their awareness of corporate matters and become more involved in corporate policy and decision making.

- ***Monitoring the performance of the CEO and top management.*** Boards are increasingly concerned with developing methods to more effectively monitor CEO and top management performance. Boards appear to be taking a more offensive approach in this regard; their goal is to improve their ability to anticipate and correct deficiencies before real performance problems become evident. This means that Boards are looking more closely at the adequacy of information they are provided, and where necessary, requesting more and better reporting of critical performance data.

- ***Redefinition of Board oversight.*** Much recent public attention directed at Boards has questioned the definition and quality of oversight a Board can (and should) provide, given the complex nature and fast pace of business today. Many Board members are concerned that Boards increasingly will be forced to monitor more closely the operational execution of management as well as its strategic direction. Balancing the role of the Board—to be involved enough to be knowledgeable, but not so involved as to interfere with or undertake management responsibility—is an issue much on the minds of today's directors. The increasing expectations shareholders have regarding director responsibility, coupled with the increasing responsibility assigned to directors through litigation, are forcing Boards to become more involved in the day-to-day management of the company. However, many directors are asking just how much outside directors should involve themselves with the detailed running of the organization.

Results of the Study

Organization of the Board

Composition of the Board

Corporate Boards today consist of 12 members, on average, a size that has remained relatively constant over the last decade. Boards of financial services companies are larger than those of both manufacturing and nonmanufacturing companies. The trend in recent years toward larger Boards in the financial services industry appears to have reached its crest. Companies in the financial services industry reported Boards averaging 17 members, slightly smaller than the average size of 18 reported in our last study (1983) but larger than the average Boards of 15 and 16 members reported in 1979 and 1981, respectively. While Boards of Directors in this industry continue to play an important role in expanding the customer base, the increased pressure to staff Boards with unaffiliated, nonmanagement directors appears to have curtailed the practice of inviting influential members of the community and executives of the largest customers to serve on the Boards of commercial banks and thrift institutions. Both manufacturing and nonmanufacturing companies reported Boards averaging 11 members, consistent with our findings in earlier studies.

Board size tends to increase gradually as company size increases (see Tables 4 through 6). This relationship of Board size to company size is strong and is evident in all three industry groups. Overall, companies with less than $1 billion in sales or assets reported an average Board size of 10 members, while companies with sales or assets over $1 billion reported an average Board size of 15 members.

There are marked differences in Board size by individual industry, even within the same industry group (see Table 7). Among the manufacturing and nonmanufacturing industries, the smallest Boards were reported in the electrical machinery, instruments, and business services industries (an average of nine members), while the largest Boards were reported in the petroleum industry (an average of 14 members). The difference in Board size is undoubtedly related to the average size of the companies in each industry segment. Companies in the business services industry, for example, had the smallest reported average sales size of any industry, while companies in the petroleum

industry had the largest reported average sales size. Among the financial services industries, commercial banks had the largest Boards (an average of 19 members), while thrifts and insurance companies had the smallest Boards (an average of 13 members).

Table 4

Manufacturing Group:

Average Composition of the Full Board, by Sales Volume

SALES VOLUME	Number of Directors	Management Directors	Nonmanagement Directors
Under $25 Million	7	30%	70%
$25-50	7	34	66
$50-100	8	29	71
$100-200	9	34	66
$200-500	10	33	67
$500-1 Billion	11	30	70
$1-2	13	28	72
$2-5	13	29	71
$5-10	14	24	76
Over $10 Billion	17	35	65
All Levels	11	31%	69%

Table 5

Nonmanufacturing Group:

Average Composition of the Full Board, by Sales Volume

SALES VOLUME	Number of Directors	Management Directors	Nonmanagement Directors
Under $25 Million	8	29%	71%
$25-50	7	32	68
$50-100	8	36	64
$100-200	10	33	67
$200-500	11	32	68
$500-1 Billion	11	27	73
$1-2	12	27	73
$2-5	13	28	72
Over $5 Billion	17	23	77
All Levels	11	30%	70%

Table 6
Financial Services Group:
Average Composition of the Full Board, by Assets

ASSETS	Number of Directors	Management Directors	Nonmanagement Directors
Under $500 Million	12	32%	68%
$500-1 Billion	13	18	82
$1-2	14	24	76
$2-5	17	21	79
$5-10	20	17	83
Over $10 Billion	20	22	78
All Levels	17	22%	78%

Board composition, in terms of the proportion of management and nonmanagement directors, is virtually unchanged from our 1981 and 1983 studies. Overall, 71% of the Board members are nonmanagement directors. This is greater than our finding in 1979 that 65% of directors were nonmanagement, and confirms the finding in our last study which indicated the end of the trend toward increasing representation by nonmanagement directors.

According to the American Bar Association's guidebooks, the corporation should determine the appropriate Board size and composition necessary to accomodate several objectives: 1) the Board should be large enough to allow nonmanagement directors to staff a minimum of three working Board committees (Audit, Compensation, Nominating); 2) key members of senior management should serve on the Board; and 3) the Board should function effectively in terms of discussion and decision making.

It now appears that a two-thirds to three-quarters majority representation by nonmanagement directors may be the balance of nonmanagement to management directors best suited to meeting these broad objectives.

The financial services group had the highest reported percentage of nonmanagement directors—78%—compared to 69% for the manufacturing industry group and 70% for the nonmanufacturing industry group. These findings are consistent with those reported for earlier years.

Table 7
Individual Industries:
Average Composition of the Full Board

	Number of Directors	Management Directors	Nonmanagement Directors
MANUFACTURING GROUP			
Durable Goods			
Basic Materials	11	33%	67%
Electrical Machinery	9	31	69
Fabricated Metal Products	10	31	69
Instruments	9	28	72
Machinery	10	30	70
Primary Metals	11	28	72
Transportation Equipment	10	24	76
Nondurable Goods			
Chemicals	13	32	68
Food Products and Tobacco	13	36	64
Paper Products	11	29	71
Petroleum	14	33	67
Publishing	12	33	67
Textiles and Apparel	10	35	65
NONMANUFACTURING GROUP			
Business Services	9	32	68
Communications	12	25	75
Construction and Contracting	12	36	64
Mining and Energy Extraction	10	29	71
Retail Sales	11	40	60
Transportation	13	20	80
Utilities	12	21	79
Wholesale Trade	10	40	60
Health Care	11	40	60
FINANCIAL SERVICES GROUP			
Banking (Commercial)	19	18	82
Banking (Thrift Institutions)	13	21	79
Diversified Financial Services	14	36	64
Insurance	13	30	70

The percentage of nonmanagement directors varies considerably by individual industry as well. For example, among the manufacturing and nonmanufacturing industries, transportation reported the greatest percentage of nonmanagement directors (80%) and retail sales, wholesale trade, and health care reported the smallest (60%). Among the financial services industries, commercial banks reported the largest average percentage of nonmanagement directors (82%) and diversified financial services the smallest (64%).

While nonmanagement directors make up the majority of Board membership of public corporations, few companies have guidelines on how much stock should be owned by a director. Overall, 17% of companies have guidelines, with financial services companies far more likely to have them (44%) than either manufacturing or nonmanufacturing companies (13%). Of the companies reporting established guidelines on stock ownership, most (76%) state their guidelines in terms of a minimum number of shares which should be owned. The number varies from 1 to 1,000 shares, although two-thirds of those with a guideline on minimum share ownership require ownership of 100 shares. Six percent of companies state their guidelines in terms of a minimum dollar value of shares and 18% have some other type of stock ownership guidelines.

Management directors represent 29% of Board membership. The Chief Executive Officer is almost universally tapped to be on the Board. Almost half the companies include the Chief Operating Officer on the Board as well. Other management directors frequently reported as Board members include the top financial officer and operating group vice presidents (see Table 8).

Table 8
Top Executives:
Percentage of Companies Having Each Executive on the Board

POSITION	Manufacturing Group	Nonmanufacturing Group	Financial Services Group
Chief Executive Officer	98%	98%	98%
Chief Operating Officer	46	50	47
Top Financial Officer	37	37	15
Group Vice Presidents	17	12	13

"Affiliated" nonmanagement directors make up only 7% of all Board members. Affiliated directors are Board members who have recently engaged in, or propose to engage in, transactions that are material to the corporation, or who have close family ties to a key member of management. The relatively small number of affiliated directors is another indication of the independence of today's Boards. While there is little variation among the industry groups in the percentage of affiliated directors (the manufacturing and nonmanufacturing industry groups average 7%, the financial services industry group, 6%), the proportion of affiliated directors varies widely among individual industries, ranging from a low of 3% in the paper and construction and contracting industries to a high of 13% in the insurance industry.

Board Meetings

The number of full Board meetings has remained relatively stable over the past few years. On average, the full Board meets seven times per year (see Tables 9 through 12). Companies in the financial services industry group reported meeting nine times per year on average, contrasted with the seven meetings per year reported by both manufacturing and nonmanufacturing companies. Boards in the financial services industry meet more frequently largely to monitor loans and review the credit status of major customers on an ongoing basis.

Table 9

Manufacturing Group:
Average Number of Full Board Meetings and Time Spent by Directors, by Sales Volume

SALES VOLUME	Number of Meetings per Year	Number of Hours per Month
Under $25 Million	6	6
$25-50	5	5
$50-100	5	6
$100-200	6	6
$200-500	6	7
$500-1 Billion	6	8
$1-2	8	10
$2-5	8	9
$5-10	8	9
Over $10 Billion	11	8
All Levels	7	7

Table 10

Nonmanufacturing Group:
Average Number of Full Board Meetings and Time Spent by Directors, by Sales Volume

SALES VOLUME	Number of Meetings per Year	Number of Hours per Month
Under $25 Million	6	5
$25-50	6	6
$50-100	5	6
$100-200	6	4
$200-500	6	7
$500-1 Billion	7	9
$1-2	9	8
$2-5	8	9
Over $5 Billion	9	12
All Levels	7	7

Table 11

Financial Services Group:
Average Number of Full Board Meetings and Time Spent by Directors, by Assets

ASSETS	Number of Meetings per Year	Number of Hours per Month
Under $500 Million	8	7
$500-1 Billion	12	8
$1-2	10	6
$2-5	8	5
$5-10	9	6
Over $10 Billion	8	8
All Levels	9	6

In both the manufacturing and nonmanufacturing industry groups, meeting frequency increases with company size. The largest companies (sales volumes over $1 billion) reported the greatest average number of meetings (eight). But as we have reported in earlier studies, it was the medium size companies in the financial services industry group (those with assets of $500 million to $1 billion) that reported having the most frequent meetings (twelve).

Meeting frequency also varies on an individual industry basis. Not unexpectedly, the Boards of commercial banks and thrift institutions meet more frequently than the Boards of companies in other industries. These companies' Boards meet an average of ten times per year, while the Boards of companies in the wholesale trade and health care industries meet least frequently, only five times per year.

The use of telephone conference calls is becoming a more popular means of conducting Board meetings. Seventeen percent of companies reported conducting at least one *scheduled* meeting of the full Board by telephone conference call. This practice is more widespread in the manufacturing and nonmanufacturing industry groups (20% and 16%, respectively, reported teleconferencing)

Table 12

Individual Industries:
Average Number of Full Board Meetings and Time Spent by Directors

	Number of Meetings per Year	Number of Hours per Month
MANUFACTURING GROUP		
Durable Goods		
Basic Materials	6	8
Electrical Machinery	6	6
Fabricated Metal Products	6	7
Instruments	6	10
Machinery	6	7
Primary Metals	7	8
Transportation Equipment	6	7
Nondurable Goods		
Chemicals	8	8
Food Products and Tobacco	7	8
Paper Products	7	8
Petroleum	8	5
Publishing	7	7
Textiles and Apparel	7	7
NONMANUFACTURING GROUP		
Business Services	6	6
Communications	7	7
Construction and Contracting	6	7
Mining and Energy Extraction	6	6
Retail Sales	6	8
Transportation	7	9
Utilities	9	7
Wholesale Trade	5	8
Health Care	5	7
FINANCIAL SERVICES GROUP		
Banking (Commercial)	10	7
Banking (Thrift Institutions)	10	7
Diversified Financial Services	6	6
Insurance	6	6

than in the financial services industry (7% reported the practice). Boards are satisfied with their current meeting schedule. Virtually all companies (97%) reportedly had no plans to change meeting frequency.

Overall, companies reported that the average director spends approximately seven hours monthly on Board activities, including committee duties. This is down slightly from the eight hours reported in our last study. Time spent on Board activities tends to increase gradually as company size increases, although there is little variation in time spent by industry group.

Use of Outside Consultants

In their efforts to become both more efficient and effective, Boards have turned to outside consultants for assistance on specific issues and problems (see Table 13). Almost one-third (31%) of Boards reported regularly employing outside advisors in their deliberations. Legal advice is sought most frequently by Boards, with 22% of companies reporting that their Boards employ consultants for assistance on legal matters. Seventeen percent of companies rely on consultants to provide assistance to Boards on compensation issues. In general, the Boards of financial services companies use consultants most (43% reported regular use), employing them more often than nonmanufacturing companies (38%) and almost twice as often as the Boards of manufacturing companies (24%).

Table 13

Use of Outside Consultants:

Percentage of Companies Regularly Employing Consultants for Specific Issues

AREA OF USE	Manufacturing Group	Nonmanufacturing Group	Financial Services Group
Legal	17%	25%	33%
Compensation	13	20	27
Financial Management	8	15	17
Executive Selection	6	7	12
Organizational Matters	3	6	4
Other Issues	4	5	8
Total Percentage Using Consultants	24%	38%	43%

Information Provided to Board Members

Companies provide their directors with a wide variety of information (see Table 14). The information provided is generally of 3 types:

- information dealing with the Board and its duties, functions, and organization;
- information dealing with the company, generated internally; and
- information dealing with the company, generated externally.

In the first category, information dealing with the Board and its activities, most companies regularly provide Board members with copies of resolutions and committee reports. New directors are typically introduced to their Board duties through information provided on director duties, including copies of insider trading rules and reporting regulations, conflict of interest policies, guides on duties and responsibilities of directors, and corporate codes of conduct. Additionally, new directors are often given the opportunity to attend orientation visits to company facilities.

Information about the company generated internally and provided regularly to Board members most often includes meeting agendas and financial reports. Also provided as additional information are a variety of operations-related items such as the CEO's monthly operations report and employee newsletters. Some companies also provide Board members with copies of marketing brochures, personnel notices, and mailings to customers. New directors are generally provided with basic background information about the company, its historical financial results, its current operations and plans, and copies of the corporation's articles of incorporation and by-laws.

Information about the company generated externally and provided to Board members includes security analysts' reports, industry data and comparisons, newspaper clippings, and press releases. Though they recognize that information on day-to-day operational issues is generally not provided to directors and is not necessarily appropriate for the Board's fulfillment of its oversight

responsibilities, many directors, nevertheless, expressed distress over what they view as a lack of high quality and, often, timely data dealing with the issues with which they must be concerned in their roles as overseers of the corporation.

Table 14

Informational Material:

Percentage of Companies Providing Information to Board Members

	Manufacturing Group	Nonmanufacturing Group	Financial Services Group
Provided Regularly:			
Meeting Agenda	96%	89%	71%
Financial Reports	93	90	71
Resolutions	60	59	47
Special Committee Reports	43	42	38
Standing Committee Reports	42	42	33
Other	25	23	29
Provided as Additional Information:			
CEO's Monthly Operations Report	44	43	30
Employee Newsletters	32	44	44
Marketing Brochures	12	12	23
Personnel Notices	12	12	8
Mailings to Customers	5	11	21
Other	25	22	29
Provided to New Directors:			
Historical Financial Results	77	73	68
Articles of Incorporation, By-laws, etc.	69	66	58
Descriptions of Principal Committees of the Board	66	62	61
Basic Data Book	44	43	40
Long-Range Plan	43	37	31
Status of Litigation	26	20	8
Job Descriptions of CEO and Other Key Officers	23	18	13
Key Provisions of Major Capital Commitments	18	23	7
Other	13	16	20

Committees of the Board

As the proportion of nonmanagement directors on Boards has grown, so has the percentage of corporate Boards adopting the committee form of organization. Committees facilitate role definition, concentrate directive effort, and have become essential to the efficient functioning of the Board. They enable nonmanagement Board members to become more involved in such areas as financial reporting and internal financial controls, Board composition, and the selection and compensation of key management members and also allow nonmanagement Board members to better manage the increasing flow of information and the growing complexity of issues. Board service makes heavy demands on the nonmanagement director's time, and this, too, has contributed to the widespread adoption of the committee structure.

The most prevalent committees are the Audit, Compensation, and Executive Committees. Nominating, Finance, and Pension Review Committees also were reported frequently. The percentage of Boards having these committees has not changed substantially from our last study in 1983. Ninety-seven percent of the Boards in this year's study have an Audit Committee, compared to 95% in the previous study; 89% have a Compensation Committee, compared to 88%; 63% have an Executive Committee, compared to 66%; 43% have a Nominating Committee, compared to 48%; 22% have a Finance Committee, compared to 24%; and 21% have a Pension Review Committee, which is an additional committee surveyed this year for the first time.

Contrasted with the early 1970s, we can see that committees are far more prevalent today. The Conference Board's 1973 study reported that only 46% of their participating companies had an Audit Committee, 69% had a Compensation Committee, and 7% had a Nominating Committee.

In this year's study, many companies reported having several other standing committees as well. These included such committees as the Long-Range/Strategic Planning Committee, Management Succession Committee, Corporate Responsibility and Ethics Committee, Legal Affairs/Litigation Committee,

Investment Committee, Stock Options Committee, Legislative and Government Affairs Committee, Human Resources Committee, R&D/Science & Technology Committee, International Committee, Public Relations/Consumer Committee, and the Mergers and Acquisitions Committee.

The use of committees varies with company size. Because of the more complex responsibilities of their Boards, stock exchange pressures, and SEC disclosure requirements, larger companies are more likely to have more and better defined committees. The use of committees also varies by industry group. Because of the larger average size of their Boards and the relatively greater volume of operating business decisions requiring Board approval, financial services companies, for example, are more likely to have Executive Committees than are their manufacturing counterparts.

Tables 15 through 17 show the prevalence of each committee within the industry groups by company size. Tables 18 through 20 show the average composition and average number of meetings per year of each committee for each industry group.

Table 15

Manufacturing Group: Prevalence of Committees, by Sales Volume

SALES VOLUME	Audit	Compensation	Nominating	Executive	Finance	Pension Review	Other
Under $25 Million	91%	91%	0%	9%	18%	9%	18%
$25-50	83	78	17	33	11	6	17
$50-100	100	80	12	44	4	16	8
$100-200	98	91	40	53	9	14	16
$200-500	94	94	27	56	13	16	21
$500-1 Billion	100	93	46	63	20	24	35
$1-2	97	97	71	80	31	26	43
$2-5	100	90	62	72	49	38	51
$5-10	100	100	77	77	62	38	62
Over $10 Billion	100	100	67	89	33	33	56
All Levels	97%	91%	42%	59%	22%	22%	30%

Table 16

Nonmanufacturing Group: Prevalence of Committees, by Sales Volume

SALES VOLUME	Audit	Compensation	Nominating	Executive	Finance	Pension Review	Other
Under $10 Million	80%	100%	40%	60%	0%	0%	0%
$10-25	86	57	29	43	29	29	29
$25-50	100	63	13	38	0	13	25
$50-100	95	74	21	42	0	16	11
$100-200	94	82	29	65	12	18	6
$200-500	97	89	39	58	24	16	16
$500-1 Billion	100	100	36	64	11	21	21
$1-2	100	84	64	68	40	16	44
$2-5	97	93	70	77	33	20	40
Over $5 Billion	100	91	73	73	64	36	73
All Levels	97%	87%	45%	62%	23%	19%	27%

Table 17

Financial Services Group: Prevalence of Committees, by Assets

ASSETS	Audit	Compensation	Nominating	Executive	Finance	Pension Review	Other
Under $500 Million	100%	83%	25%	58%	8%	33%	25%
$500-1 Billion	100	71	14	43	0	29	29
$1-2	100	80	40	60	30	30	40
$2-5	100	83	44	78	17	17	72
$5-10	100	95	40	95	20	30	60
Over $10 Billion	100	100	63	94	31	19	63
All Levels	100%	88%	40%	77%	19%	25%	52%

Table 18

Manufacturing Group:

Average Composition of Committees and Average Number of Meetings per Year

COMMITTEE	Number of Directors	Management Directors	Nonmanagement Directors	Number of Meetings per Year
Audit	4	3%	97%	3
Compensation	4	7	93	3
Nominating	4	17	83	2
Executive	5	48	52	4
Finance	6	28	72	3
Pension Review	4	32	68	3
Other	5	19	81	2

Table 19

Nonmanufacturing Group:

Average Composition of Committees and Average Number of Meetings per Year

COMMITTEE	Number of Directors	Management Directors	Nonmanagement Directors	Number of Meetings per Year
Audit	4	4%	96%	3
Compensation	4	7	93	2
Nominating	4	15	85	1
Executive	5	44	56	4
Finance	5	30	70	4
Pension Review	4	26	74	3
Other	5	15	85	2

Table 20

Financial Services Group:

Average Composition of Committees and Average Number of Meetings per Year

COMMITTEE	Number of Directors	Management Directors	Nonmanagement Directors	Number of Meetings per Year
Audit	5	4%	96%	4
Compensation	5	7	93	3
Nominating	5	10	90	2
Executive	7	33	67	9
Finance	7	25	75	6
Pension Review	4	17	83	2
Other	6	20	80	5

Audit Committee The Audit Committee was the most frequently reported committee. Ninety-seven percent of the respondents (compared to 95% in 1983, 88% in 1981 and 75% in 1979) reported having this committee. The industry groups vary only slightly in this regard, with 100% of companies in the financial services industry reporting an Audit Committee.

Even among the smallest companies—those with sales or assets below $100 million—92% reported having an Audit Committee. This committee's prevalence, in part, reflects the requirement established for domestic companies whose common stock is traded on the New York Stock Exchange, as well as the interest shown by the SEC in the committee's membership and activities.

On average, the Audit Committee is composed of four members and meets three times a year. Ninety-seven percent of all Audit Committee members are nonmanagement directors. These figures do not vary much by industry, and have not changed much since our first study six years ago.

Over one-half of the respondents cited "assuring the integrity of the company's operations" as a prime responsibility of the Board. The Audit Committee plays a key role in fulfilling this responsibility by providing the communications link between the Board of Directors and the independent auditors. According to the American Bar Association's guidebooks, the Audit Committee should have primary responsibility for the following functions:

- Recommending the appointment of independent auditors.
- Consulting with the persons chosen to be the independent auditors with regard to the plan of the audit.
- Reviewing, in consultation with the independent auditors, their report of audit or proposed report of audit and the accompanying management letter.
- Consulting with the independent auditors regarding the adequacy of internal controls.

While working closely with both management and the independent auditors, the Audit Committee should remain sufficiently detached from both to be able to objectively evaluate their positions and, ultimately, their competence and character. The Audit Committee should seek out the opinions of company

management about the quality of audit personnel, their efficiency in planning and conducting the audit, and their ability to identify and help correct deficiencies in the accounting and internal controls.

In turn, the auditors should disclose to the Audit Committee whether management has an information system designed to generate the input needed for sound decision making and whether that system is functioning properly. They can and should provide assurance within reasonable limits that the corporation's policies—as well as legal and ethical codes—are being honored in practice by management and employees and that internal controls are adequate and functioning.

In addition to its responsibilities regarding the independent auditors, the Audit Committee has an important role in monitoring the internal control environment in its own right. The committee has become increasingly involved with the internal audit function, particularly since the Foreign Corrupt Practices Act of 1977. The committee has also become involved in monitoring the quality and functions of the financial management group.

Compensation Committee Almost three-quarters of the study's respondents reported "compensation of top management" as the Board's strongest area of influence. The Board's influence in this area is typically carried out through the Compensation Committee.

Eighty-nine percent of the respondents (compared to 88%, 74%, and 61% in our 1983, 1981, and 1979 studies, respectively) reported having a Compensation Committee, making the use of Compensation Committees second only to Audit Committees among the respondents. The employment of this committee does not vary substantially by company size or by industry group.

The Compensation Committee is composed, on average, of four members and meets three times a year. Overall, 93% of its members are nonmanagement directors. The number and composition of the membership and the number of meetings show no substantial change from our study of six years ago.

The Compensation Committee plays both a strategic and an administrative role. Strategically, a Compensation Committee should consider how the achievement of the overall goals and objectives of the corporation can be aided through the

adoption of an appropriate compensation philosophy and effective compensation program elements. Administratively, the committee reviews salary progression, bonus allocations, stock awards, and the awards of supplemental benefits and perquisites for key executives.

The Compensation Committee is responsible for approving the compensation arrangements for the corporation's senior management. This committee should also approve the adoption of compensation plans in which officers and directors of the corporation are eligible to participate, and the granting of stock options or other benefits under such plans. Other responsibilities of the Compensation Committee may include the following:

- Approving compensation philosophy and guidelines for the entire executive and managerial group.
- Serving in a review function overseeing the role and performance of the chief executive, especially as this affects compensation.
- Establishing an appropriate compensation level for the CEO and top executives based on a review of compensation practices for CEOs and executives in their own industry as well as other industries. The review should also consider the company's compensation philosophy, goals, and objectives.
- Reviewing the chief executive's recommendations for the compensation of individuals in the management group, including bonus allocations.
- Reviewing the management succession program. Since the Compensation Committee must review the performance of all key personnel to determine compensation allocation, this group is uniquely equipped with an in-depth knowlege of management's strengths and weaknesses.

Just as the Audit Committee has access to outside advisers to determine the integrity of the firm's financial controls, the Compensation Committee may also rely on compensation consultants to assist in its review of compensation levels and programs. Generally, the Compensation Committee receives the recommendations of the chief executive, reviews relevant analyses of compensation data, frequently either retains its own outside expertise or relies on outside advisers hired by the corporation, and then formulates/approves pay decisions.

Seventeen percent of Boards reported using consultants on a regular basis for advice on compensation issues. In many instances, the Compensation Committee will meet with such outside advisers/consultants to ascertain their views on the adequacy of the company's compensation structure and its competitiveness compared with other companies in the same industry and with companies of the same size in different industries.

Generally, the Compensation Committee is not concerned with the individual compensation of all employees but concentrates its efforts on programs and policies relating to the compensation of key executives. The committee must be independent of management so that it can become a truly effective tool for corporate governance on behalf of stockholders and provide management with objective guidance and support in matters concerning compensation.

Nominating Committee During 1984, 42% of the responding companies added at least one new outside director to the Board. Over one-third of these companies reported adding two or more outside directors. Board vacancies for 1985 are expected by almost one-half of the participants, and already one-third of companies report anticipated vacancies in 1986. The Nominating Committee will play a key role in filling these vacancies.

The Nominating Committee is a relatively recent phenomenon. In our study of 1981, we reported that 34% of the respondents had a Nominating Committee, and in our first study in 1979, this figure was reported as 19%. This year, 43% of the responding companies reported having a Nominating Committee, almost equal to the 48% we reported in our 1983 study. Although there is little variation in prevalence among industry groups, larger companies are much more likely to have a Nominating Committee than smaller companies. Approximately two-thirds of the companies with sales or assets over $1 billion reported having a Nominating Committee, compared to 17% of the companies with sales or assets of less than $100 million.

The Nominating Committee meets less often than the Audit and Compensation Committees. Our data shows that, on average, it meets twice a year, although many Nominating Committees did not meet at all during 1984. Nominating Committees average four members, and 85% of all Nominating Committee members are nonmanagement directors. These figures are similar to our findings in earlier studies.

The Nominating Committee's basic responsibility is to thoroughly search and screen candidates for Board vacancies. To fulfill this responsibility, the Nominating Committee should consider the broader issues of composition and organization of the Board, including committee assignments and individual Board membership.

In addition, the Nominating Committee should review candidates recommended by the CEO, other members of the Board, individual shareholders, and other interested parties. Because the CEO is in an excellent position to understand the personnel needs of the Board, the Nominating Committee should work closely with the CEO to develop candidate specifications for Board membership. In order to identify and generate information about the most desirable Board candidates, the Nominating Committee in many instances establishes a resource system, which draws upon the assistance of both staff members and outside advisers.

The Nominating Committee should discuss potential candidates with the full Board prior to discussions with the candidates themselves. This gives Board members a chance to express any reservations they may have about a potential candidate and precludes the possibility that the Board will later have to deny the nomination of a candidate who has already been asked whether he or she would like to serve.

Candidates recommended for Board membership come from a variety of sources (see Table 21). Companies in our study most frequently cited prior contact with the CEO and with other Board members as sources of new nonmanagement directors. The Nominating Committee, either through its own efforts or through the use of outside advisers and search consultants, was cited as the next most frequent source of new candidates.

Table 21

Sources of New Directors:

Percentage of Companies Citing Each Source

SOURCE	Manufacturing Group	Nonmanufacturing Group	Financial Services Group
Known to CEO	95%	85%	85%
Known to Member of Nominating Committee	46	46	47
Known to Other Board Members	85	80	88
Known to Senior Management	33	28	43
Referred by Stockholder	5	4	4
Referred by Bank, Investment Banker, Other Financial Institution	7	9	1
Referred by Outside Legal Counsel	4	5	0
Referred by Outside Accounting Firm	2	2	0
Referred by Search Firm/Consultant	9	6	9

Nominating Committees play a key role in selecting key corporate executives by evaluating internal and external candidates. For this reason, Nominating Committees also are assigned the task of reviewing top management succession planning.

An additional responsibility assigned to the Nominating Committee is the evaluation of Board and Board member effectiveness. Although, as we reported earlier, our findings indicate that a minority of companies (less than 10%) subject their Boards to a formal performance and contribution appraisal, in one-third of the companies where such a review is conducted, it is done by the Nominating Committee.

As is the case with the Audit and Compensation Committees, the Nominating Committee is relying increasingly on outside advisers. These advisers help to screen candidates and to provide greater assurance of independence in the selection of candidates—independence both in fact as well as in appearance. These outside advisers might include the firm's legal counsel or investment banker or may be executive search consultants retained to locate and screen a number of candidates.

This year's figures on the sources of new directors indicate that Nominating Committees have started to become institutionalized and are now recognized as an efficient form of introducing potential new Board members to the company. The growing use of this committee also reflects the greater proportion of nonmanagement Board members and the continued emphasis on developing a Board that is independent of management.

A Board of Directors is only as strong and effective as the individuals who serve on it. Therefore, the long-term effectiveness of the Nominating Committee lies in its ability to create a strong, viable, and dynamic Board that can work effectively with management in meeting the challenges facing the corporation.

The Nominating Committee is the keystone Board committee for developing a Board of Directors that is independent of management. Without a strong Nominating Committee made up of nonmanagement directors, new Board members tend to be selected by management. Such candidates may be somewhat less objective in reviewing management's performance and plans than others independently proposed by nonmanagement members of the Board.

Executive Committee An Executive Committee is established and granted broad powers to assure that important matters that arise between Board meetings and cannot wait for the next scheduled meeting will receive timely attention. The Executive Committee also serves as a sounding board for general management problems or matters that affect the corporation as a whole.

Companies often assign retired CEOs or other senior management executives of the company to serve on this committee. This helps keep them involved in the management process. The chairmen of key Board committees also frequently serve as members of the Executive Committee.

The percentage of Boards using Executive Committees has not changed substantially in recent years. Overall, 63% of the companies in our study reported having an Executive Committee, compared to 66%, 64%, and 51% in our 1983, 1981, and 1979 studies, respectively. Financial services companies reported having this committee much more frequently than either manufacturing or nonmanufacturing companies; 77% of the financial services companies reported having an Executive Committee compared to 59% and 62% for the

manufacturing and nonmanufacturing industries, respectively. The prevalence of this committee among financial services companies reflects the large size of their full Boards (17 members compared to 11 reported for both manufacturing and nonmanufacturing companies) and the need for frequent review of operating business decisions between full Board meetings.

On average, the Executive Committee is made up of five members, and it meets five times a year, more frequently than any other committee. Nonmanagement members comprise the majority of the committee's membership, averaging 56% in all companies that reported having this committee. This percentage is lower than that of any other committee, and it may reflect the importance of the committee's management role. In financial services companies, these committees tend to be larger than average—seven members compared to five in the other industry groups. On average, these committees also meet more frequently in financial services companies—nine times a year compared to four times in the other industry groups. These findings are similar to those of previous studies.

Finance Committee Only 22% of the companies surveyed reported having Finance Committees, far fewer than any other committee with the exception of the Pension Review Committee. Its use by Boards has not changed substantially in recent years; 24% reported having this committee in 1983, 21% in 1981, and 16% in 1979. There is little variance among the industry groups in this regard. In all three industry groups, the Finance Committee is more prevalent in larger companies.

On average, Finance Committees have six members, and overall, 72% of all Finance Committee members are nonmanagement directors. The Finance Committee meets approximately four times a year. In financial services companies, the Finance Committee, like the Executive Committee, tends to be larger than in other industry groups (seven members versus five in nonmanufacturing companies and six in manufacturing companies) and to hold more frequent meetings (six a year versus three in manufacturing companies and four in nonmanufacturing companies). Again, these findings are similar to those of previous studies.

As for its responsibilities, the Finance Committee is primarily involved with financial decisions and planning. Its duties include:

- Staying informed on a timely basis about the company's financial status.

- Evaluating the financial information it receives and developing conclusions as to any plan of action that is needed.
- Advising corporate management, as well as the Board, on financial matters. In some cases, the Finance Committee has the authority to act for the full Board between meetings but generally is not empowered to act on its own.

Pension Review Committee This is the first year we have surveyed companies for information specifically on Pension Review Committees. Our findings indicate that although it is the least prevalent of any committee surveyed, reported by 21% of the respondents, it is a fairly widespread form of organization. Pension Review Committees were reported with approximately the same frequency in all three industry groups: by 22% of manufacturing companies, 19% of nonmanufacturing companies, and 25% of financial services companies. Among manufacturing companies, the Pension Review Committee is more prevalent in larger companies. This relationship is not evident in the other industries.

The Pension Review Committee consists of four members, on average, and meets three times per year. There is little variation by industry group in this regard. Overall, seventy-two percent of the members are nonmanagement directors.

The growth of pension assets in many companies helps to account for the prevalence of this committee. In some companies, in fact, the market value of the pension fund exceeds all other assets. In addition, as pension regulations and funding requirements have grown in complexity and magnitude, the Pension Review Committee has emerged to fulfill an important oversight role. Its major responsibilities include:

- Reviewing and approving corporate pension policy and formal pension plans and amendments.
- Reviewing actuarial recommendations and making recommendations regarding the corporation's contribution to the pension plans.
- Selecting the asset managers and providing guidance on the specific investment philosophy to be applied in the ongoing management of the funds.

- Monitoring the performance of the corporate pension funds.
- Monitoring government actions with respect to pension governance and reporting requirements.

The role of the Pension Review Committee in fund management generally is limited to selecting investment advisors and establishing guidelines on the mix of investment vehicles to be applied. However, the committee plays an important role in monitoring the performance of the funds and ensuring that the long-term performance goals of the fund are balanced against strong pressures for short-term results.

Board Compensation

Overall Trends

As attention has once again focused on the Board of Directors and its role and responsibilities, corporations are finding it increasingly difficult to attract and retain qualified directors. Corporations have begun to recognize the need for an appropriate compensation and benefits package for directors to acknowledge the high level of responsibility they bear, the heavy demands a directorship makes upon their time, and the increasing competition for top director talent.

In addition, while the proportion of nonmanagement directors on Boards has remained relatively stable in recent years, both corporations and prospective Board members have become more discriminating in their selection criteria for Board service, increasing the importance of the compensation and benefits package.

Virtually all of this year's study participants reported compensating their nonmanagement directors. Overall, 80% of respondents reported paying both an annual retainer and a per-meeting fee. This number does not vary substantially by industry group. On average, 13% of the manufacturing companies pay an annual retainer only, and 5% pay a meeting fee only. In nonmanufacturing these figures are 13% and 8% and in financial services 7% and 10%, respectively.

In general, when all three methods of payment to Board members are averaged, compensation in the manufacturing and nonmanufacturing industry groups is about equal. Compensation in the financial services industry trails that in manufacturing by 16%. Within each of these industry groups, directors receiving both an annual retainer and a per-meeting fee have the highest average total compensation, followed, at a slightly lower level, by directors receiving an annual retainer only, and, at a much lower level, by directors receiving a per-meeting fee only.

From 1984 to 1985, compensation increases averaged 6% for all methods of payment combined. This equals the increase reported in our last study, but is less than that reported in prior years. Compensation increased 7% above 1984 levels for companies paying a combined retainer and meeting fee, 4% for companies paying a retainer only, and 9% for companies paying a meeting fee only. By industry group, compensation increased 9% in financial services companies and 6% in both manufacturing and nonmanufacturing companies. In our study two years ago, financial services companies also reported the largest rate of increase in compensation. While actual compensation tends to be lowest in the financial services industry group, it appears that the industry has stepped up its increases to bring compensation levels closer to those found in the other industry groups.

The outlook for director compensation in the future suggests a continuation of moderate increases, with the financial services industry projecting slightly higher increases than the manufacturing and nonmanufacturing sectors. The corporate approach to granting increases in compensation to the Board differs from that taken with executives. Executives generally receive an annual compensation adjustment, but it appears that Board compensation is reviewed at less frequent intervals. When adjustments are made to Board compensation, they are larger because they are less frequent. Thirty-five percent of financial services companies indicated that they are considering increasing director compensation within the year; 30% of both manufacturing and nonmanufacturing companies reported probable increases. The average increase being considered is 15%. In the near term, while increases in cash compensation will be moderate, more attention may be given to benefits, perquisites, and noncash remuneration. Tables 22 through 24 provide information on compensation methods and levels by company size and industry group. Table 25 provides the same data for the individual industries.

Table 22

Manufacturing Group:
Compensation of Nonmanagement Directors, by Sales Volume

SALES VOLUME	Retainer and Meeting Fee		Retainer Only		Meeting Fee Only	
	Percentage of Companies Paying	Average Amount Paid	Percentage of Companies Paying	Average Amount Paid	Percentage of Companies Paying	Average Meeting Fee
Under $25 Million	45%	$ 5,780	18%	*	36%	*
$25-50	78	7,560	6	*	11	*
$50-100	68	7,300	20	$ 6,500	12	*
$100-200	74	9,780	21	12,340	5	*
$200-500	82	13,380	13	8,340	5	*
$500-1 Billion	89	16,550	11	18,500	0	*
$1-2	94	18,660	6	*	0	*
$2-5	87	22,450	13	17,800	0	*
$5-10	100	25,710	0	*	0	*
Over $10 Billion	78	28,590	11	*	11	*
All Levels	82%	$15,570	13%	$12,940	5%	$710

**Insufficient data*

Table 23

Nonmanufacturing Group:
Compensation of Nonmanagement Directors, by Sales Volume

SALES VOLUME	Retainer and Meeting Fee		Retainer Only		Meeting Fee Only	
	Percentage of Companies Paying	Average Amount Paid	Percentage of Companies Paying	Average Amount Paid	Percentage of Companies Paying	Average Meeting Fee
Under $25 Million	25%	*	8%	*	33%	*
$25-50	50	*	37	*	13	*
$50-100	53	$10,620	16	*	26	$750
$100-200	76	9,020	18	*	6	*
$200-500	74	11,020	18	$13,060	5	*
$500-1 Billion	93	19,380	7	*	0	*
$1-2	80	14,130	12	*	8	*
$2-5	90	21,060	7	*	0	*
Over $5 Billion	100	24,300	0	*	0	*
All Levels	76%	$15,630	13%	$13,130	8%	$880

**Insufficient data*

Table 24

Financial Services Group:

Compensation of Nonmanagement Directors, by Assets

ASSETS	Retainer and Meeting Fee		Retainer Only		Meeting Fee Only	
	Percentage of Companies Paying	Average Amount Paid	Percentage of Companies Paying	Average Amount Paid	Percentage of Companies Paying	Average Meeting Fee
Under $500 Million	67%	$ 8,990	0%	*	33%	*
$500-1 Billion	57	*	14	*	29	*
$1-2	60	10,320	30	*	10	*
$2-5	88	11,450	6	*	6	*
$5-10	100	14,540	0	*	0	*
Over $10 Billion	94	21,010	6	*	0	*
All Levels	83%	$13,750	7%	$11,300	10%	$530

**Insufficient data*

Companies Paying Both Retainers and Meeting Fees

The practice of paying both a retainer and meeting fee is the most prevalent method of compensating directors. As shown in Tables 22 through 24, there is little variation among the three industry groups in the percentage of companies using this method. Nonmanufacturing companies are almost as likely (76%) to pay both a retainer and meeting fee as companies in the manufacturing (82%) and financial services (83%) industries. In general, the use of the combined method of payment increases with company size. This tendency is true in all industry groups. Overall, 72% of companies with sales or assets below $1 billion use the combined method of compensation, compared to 89% of the companies with sales or assets above $1 billion.

On average, total compensation paid to directors is slightly higher in companies that pay a combined retainer and meeting fee than in companies that pay a retainer only ($15,310 under the former method when all meetings are attended versus $12,840 under the latter). Under both of the above methods, compensation is substantially greater than that paid to directors in companies that pay a meeting fee alone ($4,140 if all meetings are attended). Total compensation paid to Board members generally increases with company size, regardless of industry group.

On average, nonmanufacturing companies using the combination method of payment pay their directors the highest amount, just above compensation paid

Table 25

Individual Industries:
Compensation of Nonmanagement Directors

	Retainer and Meeting Fee		Retainer Only		Meeting Fee Only	
	Percentage of Companies Paying	Average Amount Paid	Percentage of Companies Paying	Average Amount Paid	Percentage of Companies Paying	Average Meeting Fee
MANUFACTURING GROUP						
Durable Goods						
Basic Materials	85%	$14,670	4%	*	8%	*
Electrical Machinery	76	13,510	11	$ 8,800	13	$420
Fabricated Metal Products	71	12,200	21	*	7	*
Instruments	71	13,620	29	12,920	0	*
Machinery	85	12,750	11	9,020	4	*
Primary Metals	77	16,770	23	*	0	*
Transportation Equipment	77	16,710	23	12,600	0	*
Nondurable Goods						
Chemicals	89	20,170	5	*	5	*
Food Products and Tobacco	95	17,160	0	*	5	*
Paper Products	87	16,370	13	*	0	*
Petroleum	70	23,860	30	*	0	*
Publishing	87	15,700	13	*	0	*
Textiles and Apparel	90	13,970	0	*	10	*
NONMANUFACTURING GROUP						
Business Services	70	12,000	19	11,100	11	*
Communications	85	18,360	0	*	8	*
Construction and Contracting	100	17,640	0	*	0	*
Mining and Energy Extraction	65	16,000	18	*	12	*
Retail Sales	64	15,950	18	11,880	11	*
Transportation	79	15,870	11	*	5	*
Utilities	98	14,620	0	*	2	*
Wholesale Trade	56	22,600	33	14,830	11	*
Health Care	13	*	38	*	25	*
FINANCIAL SERVICES GROUP						
Banking (Commercial)	86	11,850	2	*	12	490
Banking (Thrift Institutions)	67	18,180	25	*	8	*
Diversified Financial Services	100	18,140	0	*	0	*
Insurance	73	15,170	20	*	7	*

**Insufficient data*

by companies in the manufacturing group ($15,630 in the former group if all meetings are attended versus $15,570 in the latter group) and more than companies in the financial services industry group ($13,750).

The compensation gap among industry groups has narrowed considerably since our last study. It appears that there is now no substantive difference in compensation between the manufacturing and nonmanufacturing industry groups based on this method of payment. In our study two years ago, among companies paying both a retainer and meeting fee, compensation in manufacturing was 6% ahead of that in nonmanufacturing, and four years ago, compensation paid by manufacturing companies was 30% above the nonmanufacturing group. Similarly, compensation paid in manufacturing this year is 14% ahead of that in the financial services segment, compared to a difference of 22% two years ago and a gap of 64% reported four years ago.

On an individual industry basis, the petroleum and wholesale trade industries reported the highest average levels of compensation ($23,860 and $22,600, respectively). Directors of the commercial banking and business services industries receive the lowest average total remuneration ($11,850 and $12,000, respectively). Since compensation tends to increase with company size, much of this difference in compensation can be attributed to the differences in average company size within each industry.

Companies Using the Retainer-Only Method

Use of the retainer-only form of compensation is more prevalent among manufacturing and nonmanufacturing companies than among financial services companies. Thirteen percent of both manufacturing and nonmanufacturing companies use the retainer-only form, compared to 7% of the financial services companies. Similar to findings reported for companies using the combined compensation method, compensation increases with company size, regardless of industry group. The nonmanufacturing group reported the highest average annual retainer ($13,130), followed by the manufacturing group ($12,940), and the financial services group ($11,300).

Companies Using the Fee-Only Method

The results of our study showed that the fee-only method of compensation is used primarily by smaller companies. Of the companies with sales above $1 billion, only 2% reported using this method. Less than 5% of the financial services companies with assets greater than $1 billion reported paying only a

meeting fee. In contrast, 10% of companies with sales or assets less than $1 billion use this method, and almost one-fourth of the companies with sales or assets of less than $50 million use the fee-only method.

Overall, financial services companies reported the most frequent use of the fee-only method of payment. Ten percent of the companies in this group use it, compared to 5% in the manufacturing industry group and 8% in the nonmanufacturing industry group. This may, in part, be so because companies in the financial services industry tend to have larger Boards and more frequent meetings than the other companies in our study.

Board members who are paid a meeting fee only, on average, earn considerably less than their counterparts who are paid by the other methods, regardless of industry group. Assuming all meetings are attended, directors who are paid by this method earn an average of $4,200 in the manufacturing industry group, $3,970 in the nonmanufacturing industry group, and $4,350 in the financial services industry group.

Compensation of Management Directors

In most instances, management directors are compensated as employees and do not receive additional compensation for their work as Board members. In this year's study, only 11% of the survey respondents reported compensating their management directors, compared to 14% in our previous study. Financial services companies are most likely to provide compensation (20%), while both manufacturing and nonmanufacturing companies reported compensating management directors at an average of less than half that rate (9%). Most companies that compensate management directors pay a meeting fee only.

Table 26 shows the relative use of the three methods of compensation for management directors and the amounts paid.

Table 26
All Industry Groups:
Compensation of Management Directors

	Retainer and Meeting Fee		Retainer Only		Meeting Fee Only	
	Percentage of Companies Paying	Average Amount Paid	Percentage of Companies Paying	Average Amount Paid	Percentage of Companies Paying	Average Meeting Fee
Manufacturing Group	2%	$ 8,130	3%	$ 7,560	4%	$480
Nonmanufacturing Group	1	*	2	*	6	400
Financial Services Group	7	15,520	6	10,300	7	280

**Insufficient data*

Compensation of Honorary Directors

Twenty-three percent of companies reported having "honorary" directors or directors emeriti on their Boards. Generally, these directors are members of the Board who have retired from the Board after many years of service. Twice as many financial services companies (39%) have honorary directors as do companies in the manufacturing (19%) or nonmanufacturing (21%) industries. While a great many of these directors are not paid for their services (41% of companies do not pay honorary directors), most companies do pay honorary directors for serving on their Boards. The method of payment is evenly distributed among the three common practices: 20% pay an annual retainer only, 21% pay a meeting fee only, and 18% pay both a retainer and meeting fee. For companies paying a retainer only, the amount paid averages $7,400; for those paying a meeting fee only, it averages $430 per meeting; and for those paying both a retainer and meeting fee, the retainer averages $10,310 and the fee per meeting, $650.

Committee Compensation

Committee service by Board members continues to be recognized with additional compensation. Over 85% of the nonmanagement directors serving on committees are compensated for their committee activities. Furthermore, approximately one-third of the committee chairmen receive additional compensation above that paid to other committee members. In contrast, few management directors (4%) receive compensation for committee service.

The predominant method of paying nonmanagement committee members, reported by 70% of the companies, is by meeting fee only. The retainer-only and the combination retainer-and-meeting-fee methods are used far less frequently: 5% of companies pay an annual retainer only and 10% pay both an annual retainer and a meeting fee.

Additional compensation paid to the committee chairman is made primarily through the retainer-only method, reported by 23% of the companies overall, and through the meeting-fee-only method, reported by 10% of the companies overall. Only 1% of the companies pay the chairman both an additional retainer and an additional meeting fee.

Compensation paid to nonmanagement committee members varies in amount by type of committee, by industry group, and by method of payment. Overall, the manufacturing industry group tends to pay the highest compensation and the nonmanufacturing industry group the lowest. Committee members paid a retainer only receive the highest compensation; those paid a meeting fee only

receive the lowest. Members of the Finance and Executive Committees receive the largest amounts, and depending on the method of compensation, members of the Nominating and Pension Review Committees receive the smallest amounts.

Compensation for committee service as a percentage of compensation for regular Board membership averages 14%. This figure varies substantially by committee and industry group. Compensation for service on the Nominating Committee is the lowest, averaging 7% of the payment for regular Board membership. Compensation for membership on the Executive Committee is highest relative to the regular Board payment, averaging 24%.

Table 27 presents data on the various payment methods for service on Board committees. Tables 28 through 30 show the amounts paid for committee service and Table 31 shows the committee payment as a percentage of payment for regular Board service. Tables 32 through 34 show the percentage of companies paying an additional amount to the committee chairman and the additional amounts paid.

Table 27

All Industry Groups:
Method of Payment for Committee Service (Nonmanagement Directors)

	Retainer and Meeting Fee	Retainer Only	Meeting Fee Only
Manufacturing Group	13%	5%	68%
Nonmanufacturing Group	8	5	68
Financial Services Group	6	4	81
All Levels	10%	5%	70%

Table 28

Manufacturing Group:
Compensation of Committee Members (Nonmanagement Directors)

COMMITTEE	Retainer and Meeting Fee: Average Retainer	Retainer and Meeting Fee: Average Meeting Fee	Retainer and Meeting Fee: Average Amount Paid	Retainer Only: Average Amount Paid	Meeting Fee Only: Average Meeting Fee	Meeting Fee Only: Average Amount Paid
Audit	$1,720	$610	$3,410	$3,770	$550	$1,500
Compensation	1,180	600	3,060	3,530	540	1,630
Nominating	1,000	630	2,140	5,200	580	1,050
Executive	3,750	590	6,080	5,830	580	1,310
Finance	1,250	630	3,830	7,200	620	1,920
Pension Review	1,940	630	3,040	*	590	1,750
Other	1,420	650	3,240	*	550	1,080

**Insufficient data*

Table 29

Nonmanufacturing Group:
Compensation of Committee Members (Nonmanagement Dirctors)

COMMITTEE	Retainer and Meeting Fee: Average Retainer	Retainer and Meeting Fee: Average Meeting Fee	Retainer and Meeting Fee: Average Amount Paid	Retainer Only: Average Amount Paid	Meeting Fee Only: Average Meeting Fee	Meeting Fee Only: Average Amount Paid
Audit	$1,500	$530	$3,510	$1,440	$530	$1,550
Compensation	1,260	530	3,150	1,460	530	1,430
Nominating	590	640	2,000	*	580	1,000
Executive	2,960	520	3,180	9,200	550	1,690
Finance	1,580	620	4,930	*	610	2,100
Pension Review	*	*	*	*	570	1,690
Other	840	740	2,220	*	570	1,530

**Insufficient data*

Table 30

Financial Services Group:
Compensation of Committee Members (Nonmangement Directors)

COMMITTEE	Retainer and Meeting Fee: Average Retainer	Retainer and Meeting Fee: Average Meeting Fee	Retainer and Meeting Fee: Average Amount Paid	Retainer Only: Average Amount Paid	Meeting Fee Only: Average Meeting Fee	Meeting Fee Only: Average Amount Paid
Audit	$2,300	$530	$4,630	*	$400	$1,510
Compensation	1,900	530	5,620	*	410	1,330
Nominating	*	*	*	*	410	650
Executive	*	*	*	*	440	3,800
Finance	*	*	*	*	550	3,160
Pension Review	*	*	*	*	330	640
Other	*	*	*	*	430	1,960

**Insufficient data*

Table 31

All Industry Groups:

Committee Member Compensation as a Percentage of Regular Board Member Compensation

	Audit	Compensation	Nominating	Executive	Finance	Pension Review	Other
Manufacturing Group	13%	12%	8%	16%	14%	11%	10%
Nonmanufacturing Group	14	12	7	23	15	11	10
Financial Services Group	17	13	5	47	25	8	19
All Levels	14%	12%	7%	24%	16%	11%	12%

Table 32

Manufacturing Group:

Percentage of Companies Compensating Committee Chairmen

COMMITTEE	Percentage Paying an Additional Amount	Additional Amount Paid
Audit	41%	$2,560
Compensation	36	2,430
Nominating	40	1,750
Executive	20	3,100
Finance	37	5,880
Pension Review	36	2,630
Other	45	1,710

Table 33

Nonmanufacturing Group:

Percentage of Companies Compensating Committee Chairmen

COMMITTEE	Percentage Paying an Additional Amount	Additional Amount Paid
Audit	33%	$2,160
Compensation	32	1,850
Nominating	35	1,530
Executive	14	3,450
Finance	31	2,050
Pension Review	32	1,510
Other	43	1,660

Table 34

Financial Services Group:

Percentage of Companies Compensating Committee Chairmen

COMMITTEE	Percentage Paying an Additional Amount	Additional Amount Paid
Audit	44%	$2,170
Compensation	41	1,700
Nominating	47	1,880
Executive	20	5,630
Finance	44	2,760
Pension Review	42	840
Other	38	1,840

Director Benefits

As companies have increased the cash compensation paid to their Boards over recent years, they also have begun to focus more attention on other forms of compensation which might be used to make the total director compensation package more appropriate. The result has been an increase in the range and prevalence of benefits provided to directors.

Ninety-two percent of the responding companies reported paying the expenses incurred by nonmanagement directors in attending meetings. This is approximately the same percentage as in our previous study. The percentage of companies reimbursing or paying these expenses by industry group ranges from a low of 78% in the financial services group to a high of 95% in the manufacturing group. In 10 of the 26 industries, all responding companies reported paying director expenses. Commercial banks and thrift institutions are least likely to pay these expenses (70% and 75%, respectively).

Director liability insurance has become an important and widespread benefit for directors. Approximately 70% of companies provide some form of liability insurance coverage for directors. The average amount of coverage is $32 million (see Table 35). The amount of liability coverage provided tends to increase with size of company. Companies with less than $1 billion in sales or assets provide an average liability coverage of $17 million; this figure increases to an average of $50 million for companies with sales or assets greater than $1 billion.

Table 35

All Industry Groups:
Amount of Liability Coverage (in millions)

SALES OR ASSETS	Manufacturing Group	Nonmanufacturing Group	Financial Services Group
Under $100 Million	$10.7	$ 9.8	*
$100-500	15.8	20.1	*
$500-1 Billion	24.3	29.3	*
Over $1 Billion	47.9	63.1	$39.8

**Insufficient data*

As for other forms of insurance provided to directors, life insurance was reported by 14% of the companies, and accidental death and dismemberment (AD&D) insurance was reported by 22%. Medical and dental programs are less common, reported by 8% and 5%, respectively. A likely explanation for this lack of coverage is that nonmanagement directors employed by other companies are usually included in the life, health, and AD&D insurance programs of their primary employer.

Thirty percent of the companies surveyed provide college matching gifts and it is primarily the larger companies that include directors in this program. It is likely that more larger companies offer college matching gift programs to their employees than smaller companies, and that they simply include the directors in their programs. This benefit is offered most frequently by companies in the manufacturing industry group (36%), and least frequently by those in the financial services industry group (21%).

Stock purchase and stock option programs are the least frequently reported benefits, found at 2% and 6% of companies, respectively.

Deferred compensation plans were reported by 46% of the respondents in our study. They are more prevalent in financial services companies (57%) than in either manufacturing (46%) or nonmanufacturing (42%) companies. Deferred compensation plans allow directors to collect payment for their Board service at a later date, most often at retirement, when their total income is likely to be less and may be taxed at a lower rate. Also, as we noted in our last study, another one of the reasons for the popularity of these plans is the limit imposed on pension contributions and benefits by the Employee Retirement Income Security Act (ERISA) and the Tax Equity and Fiscal Responsibility Act (TEFRA). These Acts have limited the amount of retirement income that can be provided by the director's regular employer, which means that directors are now more interested in finding ways to supplement their retirement income.

In addition to the growth in prevalence of deferred compensation arrangements, formal retirement plans for directors have also become more common. Our study two years ago found that only 7% of companies had a retirement plan for directors. This figure has doubled to 14% today.

Overall, 61% of companies have a mandatory retirement age in effect for directors, generally age 70. Mandatory retirement is far more prevalent in larger companies: 42% of companies with sales or assets less than $1 billion require retirement, while 89% of those with sales or assets greater than $1 billion and 93% with sales or assets greater than $5 billion require it.

Among those companies providing formal retirement plans for directors, eligibility for participation is most often based on the director's meeting a requirement for a certain number of years of service and a specified age (46%), less often on a years-of-service requirement only (33%), and least often on an age requirement only (15%). Five percent of companies reported using some other criteria to determine eligibility. The majority of companies (56%) base the annual director retirement benefit on a percentage of the director's annual compensation, typically ranging from 10% to 100%. The most prevalent practice (reported by 80% of companies which pay a percentage) is to pay 100% of compensation. Ten percent of companies reported paying a fixed annual amount not tied to annual compensation and 33% determine the retirement benefit through some other method. Retirement benefits are most frequently paid either for life (by 35% of respondents) or for a term equal to years of Board service (again by 35%). Eighteen percent of companies reported paying benefits for 10 years, and 13% reported some other provision.

Two-thirds of companies with director retirement plans impose no conditions on directors for continued payment of benefits. Twenty-six percent require that the director remain available for consultation and advice and 8% impose some other condition.

Tables 36 through 38 and 40 through 42 report information on benefits provided to directors, by company size and industry group. Tables 39 and 43 present similar information by specific industry. Table 44 presents data on director retirement plans.

Table 36

Manufacturing Group:

Percentage of Companies Paying Expenses and Providing Insurance Benefits, by Sales Volume

SALES VOLUME	Expense Reimbursement	Liability Insurance	Life Insurance	Accidental Death and Dismemberment Insurance	Medical Insurance	Dental Insurance
Under $25 Million	82%	83%	0%	0%	0%	0%
$25-50	94	50	6	0	0	0
$50-100	88	76	20	20	12	8
$100-200	93	67	12	14	12	7
$200-500	95	71	11	27	7	2
$500-1 Billion	96	72	20	17	7	4
$1-2	100	80	20	31	3	0
$2-5	100	92	21	36	8	3
$5-10	100	62	31	39	15	15
Over $10 Billion	100	78	44	44	11	11
All Levels	95%	74%	17%	23%	7%	4%

Table 37

Nonmanufacturing Group:

Percentage of Companies Paying Expenses and Providing Insurance Benefits, by Sales Volume

SALES VOLUME	Expense Reimbursement	Liability Insurance	Life Insurance	Accidental Death and Dismemberment Insurance	Medical Insurance	Dental Insurance
Under $25 Million	83%	67%	0%	8%	0%	0%
$25-50	88	38	0	13	0	0
$50-100	84	58	5	16	0	0
$100-200	77	53	12	12	18	12
$200-500	97	53	13	11	16	13
$500-1 Billion	93	57	14	7	7	7
$1-2	96	76	20	40	12	8
$2-5	97	83	13	40	3	0
Over $5 Billion	100	100	36	73	9	9
All Levels	92%	65%	13%	23%	9%	6%

Table 38

Financial Services Group:

Percentage of Companies Paying Expenses and Providing Insurance Benefits, by Assets

ASSETS	Expense Reimbursement	Liability Insurance	Life Insurance	Accidental Death and Dismemberment Insurance	Medical Insurance	Dental Insurance
Under $500 Million	67%	50%	8%	17%	0%	0%
$500-1 Billion	29	29	0	0	14	0
$1-2	60	70	0	0	0	0
$2-5	89	67	0	0	0	0
$5-10	90	75	10	15	5	5
Over $10 Billion	94	81	19	38	25	19
All Levels	78%	66%	7%	13%	7%	5%

Table 39

Individual Industries:

Percentage of Companies Paying Expenses and Providing Insurance Benefits

	Expense Reimbursement	Liability Insurance	Life Insurance	Accidental Death and Dismemberment Insurance	Medical Insurance	Dental Insurance
MANUFACTURING GROUP						
Durable Goods						
Basic Materials	89%	70%	11%	11%	7%	0%
Electrical Machinery	96	74	17	24	9	4
Fabricated Metal Products	100	86	21	21	0	0
Instruments	92	67	17	29	13	8
Machinery	96	68	11	7	6	4
Primary Metals	100	62	8	46	0	0
Transportation Equipment	100	82	41	36	18	9
Nondurable Goods						
Chemicals	97	76	8	35	5	3
Food Products and Tobacco	95	71	33	24	10	10
Paper Products	100	93	13	13	0	0
Petroleum	100	80	20	10	10	0
Publishing	87	73	13	27	0	0
Textiles and Apparel	90	70	10	20	10	10
NONMANUFACTURING GROUP						
Business Services	93	48	11	11	11	11
Communications	100	62	23	31	0	0
Construction and Contracting	100	63	0	0	0	0
Mining and Energy Extraction	100	53	12	35	0	0
Retail Sales	86	54	11	18	11	11
Transportation	100	90	21	37	21	21
Utilities	88	80	14	31	4	0
Wholesale Trade	89	61	11	11	17	11
Health Care	86	63	13	13	13	0
FINANCIAL SERVICES GROUP						
Banking (Commercial)	70	70	0	8	2	0
Banking (Thrift Institutions)	75	75	8	17	33	25
Diversified Financial Services	100	71	29	43	0	0
Insurance	93	40	20	13	7	7

Table 40

Manufacturing Group: Percentage of Companies Providing Other Benefits, by Sales Volume

SALES VOLUME	Stock Purchase Plan	Stock Option Plan	Deferred Compensation Plan	Retirement Plan	College Matching Gifts
Under $25 Million	0%	38%	33%	0%	0%
$25-50	0	22	17	0	6
$50-100	0	0	8	0	12
$100-200	2	14	21	5	5
$200-500	2	7	44	13	27
$500-1 Billion	0	0	59	24	41
$1-2	0	0	57	20	51
$2-5	0	0	74	33	80
$5-10	0	0	92	39	77
Over $10 Billion	0	0	78	22	78
All Levels	1%	6%	46%	16%	36%

Table 41

Nonmanufacturing Group: Percentage of Companies Providing Other Benefits, by Sales Volume

SALES VOLUME	Stock Purchase Plan	Stock Option Plan	Deferred Compensation Plan	Retirement Plan	College Matching Gifts
Under $25 Million	0%	25%	17%	0%	0%
$25-50	13	13	13	0	13
$50-100	0	21	26	0	0
$100-200	0	0	18	0	6
$200-500	0	5	29	5	8
$500-1 Billion	0	0	46	18	29
$1-2	12	4	64	4	40
$2-5	0	3	60	27	60
Over $5 Billion	9	0	91	45	64
All Levels	3%	6%	42%	11%	26%

Table 42

Financial Services Group: Percentage of Companies Providing Other Benefits, by Assets

ASSETS	Stock Purchase Plan	Stock Option Plan	Deferred Compensation Plan	Retirement Plan	College Matching Gifts
Under $500 Million	0%	0%	25%	8%	8%
$500-1 Billion	14	0	14	0	0
$1-2	0	10	60	0	0
$2-5	6	6	50	11	11
$5-10	0	5	75	10	25
Over $10 Billion	6	0	81	25	56
All Levels	4%	4%	57%	11%	21%

Table 43

Individual Industries:
Percentage of Companies Providing Other Benefits

	Stock Purchase Plan	Stock Option Plan	Deferred Compensation Plan	Retirement Plan	College Matching Gifts
MANUFACTURING GROUP					
Durable Goods					
Basic Materials	0%	4%	41%	19%	33%
Electrical Machinery	2	15	28	9	20
Fabricated Metal Products	7	0	50	14	36
Instruments	0	13	33	17	21
Machinery	0	6	36	9	15
Primary Metals	0	0	62	23	46
Transportation Equipment	0	9	55	27	50
Nondurable Goods					
Chemicals	0	0	57	24	65
Food Products and Tobacco	0	0	67	29	57
Paper Products	0	0	60	13	53
Petroleum	0	0	60	10	40
Publishing	0	0	47	13	33
Textiles and Apparel	0	10	40	0	30
NONMANUFACTURING GROUP					
Business Services	4	11	30	7	11
Communications	0	8	69	8	39
Construction and Contracting	0	0	50	0	50
Mining and Energy Extraction	0	12	18	12	18
Retail Sales	4	4	36	11	21
Transportation	0	0	42	16	42
Utilities	6	0	61	20	35
Wholesale Trade	0	6	39	0	6
Health Care	0	50	0	0	13
FINANCIAL SERVICES GROUP					
Banking (Commercial)	6	4	60	4	18
Banking (Thrift Institutions)	0	8	58	25	0
Diversified Financial Services	0	0	71	14	43
Insurance	0	0	33	20	33

Table 44

All Industry Groups:
Retirement Plan Provisions

	Manufacturing Group	Nonmanufacturing Group	Financial Services Group
Retirement Plan's Eligibility Requirement is Based on:			
Specified Age *and* Years of Board Service	50%	48%	22%
Specified Age Only	15	14	22
Specified Years of Board Service Only	33	24	56
Other	2	14	0
The Basic Retirement Benefit Amount Payable Annually is:			
A Percentage of the Directors' Annual Compensation	54	52	78
Fixed Dollar Amount	8	19	0
Other	38	29	22
Annual Retirement Benefits Payments Are Made:			
For Life	42	19	33
For a Term Equal to Years of Board Service	27	43	56
For a Fixed Number of Years	19	19	11
Other	12	19	0
Conditions Imposed for Continued Payment of Retirement Benefits:			
None	63	67	87
Retired Director Must Remain Available for Service/Advice	27	28	13
Retired Director Must Attend Specified Meetings or Provide Specified Consulting Services	2	0	0
Other	8	5	0

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